

810-3-165-.01 Taxation of Actual Distributions By An Alabama S Corporation.

(1) Treatment of Property Distributions. An actual distribution of property (not the prorata share taken into account under §40-18-162, Code of Alabama 1975) by an Alabama S Corporation in accordance with the provisions of § 40-18-36, will be treated in the following manner:

(a) If the Alabama S corporation has no accumulated earnings and profits (from any year in which an Alabama S election was not in effect or from a merger), the distribution will not be included in the shareholder's gross income to the extent the distribution does not exceed the adjusted basis of the stock.

1. To the extent the distribution exceeds the shareholder's adjusted basis in the stock of the Alabama S corporation, the excess will be treated as a gain from the sale or exchange of property.

(b) If the Alabama S corporation has accumulated earnings and profits (from any year in which an Alabama S election was not in effect or from a merger), and the distribution does not exceed the Alabama Accumulated Adjustments Account, the distribution will not be included in the shareholder's gross income to the extent of the shareholder's adjusted basis of the stock.

1. To the extent the distribution exceeds the shareholder's adjusted basis of the stock, the distribution will be included in the shareholder's gross income as a dividend to the extent that it does not exceed the corporation's Alabama accumulated earnings and profits.

2. To the extent the distribution exceeds the corporation's Alabama accumulated earnings and profits, but not the Alabama Accumulated Adjustments Account (after application of subparagraph (b) above), the excess will not be included in the shareholder's gross income.

3. To the extent the distribution exceeds the corporation's Alabama accumulated earnings and profits and the Alabama Accumulated Adjustments Account, the excess will be treated as a gain from the sale or exchange of property.

(2) In applying the rules of this section, the shareholder's basis in his or her stock will first be adjusted as provided in Rule 810-3-164-.01 and the Alabama Accumulated Adjustments Account adjusted as provided in Rule 810-3-166-.01.

(3) Special Election. As provided in § 40-18-166(b), the Alabama S corporation may elect, with the consent of all the affected shareholders, to treat all distributions made during the taxable year as distributions first from

accumulated earnings and profits rather than from the Alabama Accumulated Adjustments Account. See Rule 810-3-166.01.

(4) Nonresident Shareholders. Nonresident shareholders who receive distributions under the provisions of this regulation are not required to include such amounts in their Alabama nonresident income tax returns, except when paragraph (3) above applies.

(5) Examples. The following examples will serve to illustrate the operation of this regulation:

(a) 1. Jones is the 100% shareholder of Acme, Inc., an Alabama S corporation which has its first year of existence in 1985, and therefore has no accumulated earnings and profits. All its income and deductions are attributed to Alabama. Jones' basis in his Acme stock at January 1, 1985 is \$1,000.

2. Acme reports the following on its tax return for the year ended December 31, 1985:

Non-separately stated income	\$1,500
Distribution to Jones on 10/31/85	2,000

3. Jones' adjusted basis in his Acme stock at December 31, 1985, before giving effect to the distribution, is computed as follows:

Basis at January 1, 1985	\$1,000
Non-separately stated income for 1985	<u>1,500</u>
Basis on December 31, 1985	<u>\$2,500</u>

4. The entire distribution to Jones on 10/31/85 is a non-taxable return of his basis. After giving effect to the distribution, Jones' basis in his Acme stock at December 31, 1985 is \$500.

(b) The facts are the same as in example (a) above, except that the distribution to Jones on October 31, 1985, is \$3,000.

1. The distribution to Jones is characterized as a non-taxable return of his basis to the extent of his adjusted basis before giving effect to the distribution. The excess of this distribution over his basis is taxed as a gain from the sale or exchange of his Acme stock. His adjusted basis on December 31, 1985 is \$2,500 before recognizing the distribution (see example (a)3, above). Therefore, Jones has a non-taxable return of basis of \$2,500 and a gain from the exchange of his stock of \$500.

(c) The facts are the same as in the example (b) above, except that Acme has accumulated earnings and profits from prior C corporation years in the amount of \$3,000.

1. Acme's accumulated adjustments account at December 31, 1985, before giving effect to the distribution is \$1,500, the amount of the non-separately stated income. The \$3,000 distribution to Jones on October 31, 1985, is characterized as follows:

Non-taxable restoration of basis to the extent of the Alabama Accumulated Adjustments Account	\$1,500
Taxable dividend paid from accumulated earnings and profits	<u>\$1,500</u>
Total Distribution	<u>\$3,000</u>

2. Jones' basis in his Acme stock at December 31, 1985, after giving effect to the distribution is \$1,000. The balance in Acme's accumulated earnings and profits account at December 31, 1985, after giving effect to the distribution, is \$1,500.

(d) The facts are the same as in example (c) above, except that Acme, with Jones' consent, has elected under Rule 810-3-166-.01 to treat all distributions in the taxable year as coming first from accumulated earnings and profits.

1. The entire distribution is characterized as a taxable dividend paid from accumulated earnings and profits. Jones' basis in his Acme stock at December 31, 1985 is \$2,500, and the balance in Acme's accumulated adjustments account at December 31, 1985 is \$1,500. Acme has no accumulated earnings and profits at December 31, 1985, after giving effect to the distribution.

(6) For tax years beginning after December 31, 1996, adjustments for distributions are made before applying the loss limitation. The stock basis is adjusted by the positive adjustments under Rule 810-3-164-.01 but is not decreased by any of the negative adjustments before taking into account any distributions.

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